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IN THE

Supreme Court of the United States

October Term, 1965
No. 1028

No. 19814
LOUIS LESSER and JEANNE LESSER, *Petitioner,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 19815
WILLIAM MALAT and ETHEL MALAT, *Petitioner,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 19816
CRAIG ADOLPHE LESSER TRUST #2, *et al.*, *Petitioners,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 19817
CATHY J. LESSER TRUST #2, *et al.*, *Petitioners,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 19818
THERESE ANN LESSER FORD TRUST #2, *Petitioner,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 19819
FRANCINE S. LESSER TRUST #2, *et al.*, *Petitioner,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

Petition for Writ of Certiorari to the United States Court of Appeals, Ninth Circuit.

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Petition for Writ of Certiorari to the United States Court of Appeals, Ninth Circuit.

Petitioners hereby petition this Court for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit.

Opinions Below.

The findings of fact and opinion of the Tax Court are reported at 42 T.C. 688. The opinion of the Court of Appeals (Appendix herein) is reported at 352 F. 2d 789. This petition is limited to the issue of depreciation.

Jurisdiction.

The judgment of the Court of Appeals was entered November 9, 1965. A petition for rehearing, and for rehearing *en banc*, limited to the issue of depreciation, was denied December 6, 1965. The jurisdiction of this Court is based on 28 U.S.C. §1254(1).

Questions Presented.

1. Where the Tax Court determines, for purposes of depreciation, a single useful life of a "building as a whole" saying that it is "giving proper consideration to the condition of any of the components that may affect the composite life of the entire structure" [R. 37], but without stating the formula on which the said composite life is based, or any figures from which it can be derived, or even the components which it included, should not the cause be remanded and the Tax Court required to disclose its formula, or state how it arrived at its determination?

2. Where petitioners purchased the property only because of a lease which the lessee executed as one of the documents in the purchase escrow, and the lessee could, under said lease, and immediately upon taking possession thereunder did, completely remodel the building, was the useful life to be determined, as the Tax Court did, on the basis of the character of the original building, or on the basis of the character of the building as so remodeled?

Statutes Involved.

Internal Revenue Code of 1954.

Sec. 167. Depreciation.

(a) General Rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

. . . .

Statement.

General.

This petition involves the income taxes of petitioners for 1959. The deficiencies determined by the Tax Court, and affirmed by the Court of Appeals, are based on adjustments in the income of two partnerships, Louis Lesser Enterprises, Ltd., hereinafter referrred to as "Enterprises," and Lesser Industrial Properties, Ltd., hereinafter referred to as "Industrial." This petition is limited to the issue of the useful life for depreciation purposes of certain industrial property.

Acquisition of the Property Involved.

On June 10, 1958, Industrial was advised by the treasurer of Beckman Instrument Corporation that that corporation was interested in selling its "Helipot" building, located at Newport Beach, California. This building had been constructed by the Beckman Instrument Corporation in July of 1957, and had since then been occupied and used by the Helipot Corporation, a "division" of Beckman Instrument Corporation [R. 16-17].

Industrial communicated with Hughes Aircraft Company, hereinafter referred to as "Hughes," to ascertain whether that corporation would be interested in leasing the Helipot building. Upon being informed that Hughes was interested in such a lease, Industrial, on June 11, 1958, secured from Beckman Instrument Corporation an option to purchase the property [R. 17].

On June 12, 1958, Industrial received from Hughes a written offer to lease the property. The offer was accepted by Industrial. Neither Enterprises, Industrial, nor any of their members nor their corporate successor, at any time had an interest in Hughes [R. 17].

On June 13, 1958, Enterprises and the Helipot Corporation entered into an agreement wherein the former agreed to purchase and the latter to sell the Helipot building. The agreement provided that the closing date of the transaction would be September 30, 1958, and that possession would be delivered on the closing date. In accordance with the terms of the agreement, the purchase from Helipot Corporation was completed, and Industrial acquired the property on September 30, 1958, at a total cost of $2,753,909.44. The purchase was made nominally by Enterprises, and the property then in turn conveyed by Enterprises to Industrial [R. 17-18].

The Helipot building would not have been purchased by Industrial without first having a lease commitment [R. 18].

Provisions of the Lease.

The basic term of the lease was 20 years [R. 19]. The rental was $25,000 per month [R. 19-20]. Beyond the basic term there were given lessee six successive 5-year renewal options at progressively reduced rentals,

but there was no renewal option given to lessor [R. 21-22].[1]

The lease provided that the lessee could erect and install such improvements in or upon the building leased thereunder, and to make such alterations to the interior thereof, as it might desire, at its own expense; and that at any time during the term of the lease, the lessee also could, at its option, remove all improvements, machinery, fixtures and equipment installed by it, except elevators, if any [R. 20-21]. On termination of the lease the lessee was obligated to surrender the building to the lessor "in good condition and repair, subject only to the effect of reasonable wear [and] tear during the term of [the] lease." [R. 20-21].

Other Findings.

The total cost of the Newport Beach property to Industrial, $2,753,909.44, was allocated by it between land and building on the basis of the property tax assessments, $88,675.88 being allocated to the land and $2,665,233.56 to the building. The total original cost of construction of the building to Industrial's vendor, about a year earlier, was $2,567,112.00 [R. 22].

The building as originally designed and constructed was usable for a variety of light manufacturing purposes and was not a one-purpose building [R. 18]. Hughes, however, upon taking possession of the building, *immediately* engaged in a five million dollar program of completely remodeling and expanding the structure, for the sole purpose of converting it into a plant for the manufacture of semi-conductors, diodes and

[1]It is mathematically obvious that the rentals during the basic term were sufficient to return to Industrial its total cost and pay it a substantial return on its investment.

transistors. Virtually all of the interior of the building was torn out; the building was extensively remodeled, and horizontal additions to the building resulted in almost doubling its original size [R. 22].

Industrial on its returns had taken depreciation of the Helipot building on the basis of a 25-year life [R. 32]. Respondent in his deficiency notices allowed depreciation of the building on the basis of a 50-year life [R. 32]. The Tax Court found that the building "when acquired by Industrial" [R. 37] had a depreciable life of 45 years "from the date of" such acquisition. [R. 22, 37]. It made no finding at all as to the life of the building as remodeled by Hughes.

Proceedings in the Courts Below.

In the trial herein petitioners called as their witness on this issue of useful life a licensed general contractor who was general manager of a firm of architects, engineers and general contractors, practicing primarily in the commercial industrial field. [R. 65-66]. He had been in that field for 25 years. [R. 65]. During the remodeling of the Helipot building he was the full-time project manager on that particular job. All the work was done under his supervision. [R. 66, 74]. In the course of his testimony he answered numerous questions of the court. [R. 65-75]. No challenge was made during the trial to his qualifications; and respondent offered no rebuttal evidence.

Just how the Tax Court arrived at its finding of a 45-year composite life is not shown in either the Tax Court's findings or its opinion. It stated only that the problem was "not susceptible of any precise mathematical solution," and that it was "one of judgment upon

the basis of the entire record, taking into account the probable useful life of the building as a whole, and giving proper consideration to the condition of any of the components that may affect the composite life of the entire structure." [R. 37]. Also, while, as indicated above, it made a finding that the building as originally designed and constructed was usable for a variety of light manufacturing purposes and was not a one-purpose building, it made no corresponding finding as to the character of the building as remodeled by the lessee.

There was, however, testimony of the said witness showing the character of the structure as remodeled, which the Tax Court did not question. The production of semi-conductors, diodes and transistors, for the sole purpose of which the lessee, as the Tax Court found [R. 22], remodeled the structure, was, he testified, "a very, very specialized type of production." [R. 71]. Indeed, as the witness stated in response to a question by the court, the structure, as remodeled by the lessee, was "more like a machine than . . . a building, very technical." [R. 67]. Also, as he testified, the method of manufacture involved is a rapidly changing one, resulting in a continuing reconstruction program. [R. 71-72]. And, as the witness further stated, on cross-examination by respondent, if the lessee removed its installations, as the Tax Court found it could at any time during the lease [R. 20-21], the building "would be an unusable building." [R. 75].

The Tax Court, nevertheless, failed to make any finding as to the character of the structure as remodeled, or, as observed above, as to the useful life of the structure as remodeled. It based its finding of useful life solely and expressly on the original structure, the

"Helipot building when acquired by Industrial" [R. 37], and consisting either of that "building as a whole," including all of the original components in their condition at the time of purchase [R. 35, 37], or consisting only of the original structure minus the components torn out in the remodeling by the lessee [R. 36]. *There is not even any way of knowing which.*

In the appeal to the Court of Appeals this issue of useful life was raised expressly on the basis of the building as remodeled by the lessee [R. 47-48, 50-51, 53, 55-56, 58, 60-61]. The Court of Appeals, nevertheless, concluding that the Tax Court's action "in determining lives and proportions by its own formula" was not clearly erroneous, affirmed, "for the reasons stated in the opinion of the Tax Court." (Appendix).

Reasons for Granting the Writ.

1. The decision below is in clear conflict with the decision of the United States Court of Appeals for the First Circuit in *Worcester County Trust Co. v. Commissioner,* 134 F. 2d 578. The court there, citing and quoting from this court's decision in *Helvering v. Taylor,* 293 U.S. 507, 55 S. Ct. 287, remanded the cause to the Board of Tax Appeals, now the Tax Court, because the determination of the Board was "without rational foundation and excessive."

Here the Tax Court's determination was clearly, indeed expressly, based on the original building, a building which did not exist during the taxable year involved. The building in existence was the building as remodeled under the terms of the lease. The evidence, page 7, *supra,* clearly shows that that building, unlike the original building, was a unique, one-purpose building. That this

is a factor which must be considered the Tax Court has itself shown. *Paul W. Frenzel v. Commissioner,* 22 T.C.M. 1391, 1402.

We are sure respondent will not question the irrationality of basing depreciation on a building not even in existence during the year involved. We submit that this is a clear conflict with the decision cited of the United States Court of Appeals for the First Circuit.

2. The decision below is in clear conflict with the decision of the United States Court of Appeals for the Tenth Circuit in *James Petroleum Corporation v. Commissioner,* 331 F. 2d 344. The Court there, citing this court's decision in *Commissioner v. Duberstein,* 363 U.S. 278, 80 S. Ct. 1190, remanded the cause to the Tax Court because, page 345:

> "There is only the finding of the ultimate fact or conclusion with no other findings to show how such conclusion was reached. . . . There being no supporting findings, we are unable to determine the basis for the decision as we cannot make nor assume findings."

On the same point it is stated in *Federal Practice and Procedure,* Barron and Holtzoff, Vol. 2B, Chap. 10, §1127, at p. 503:

> "From these expressions of the highest court it is fair to conclude that the findings of fact must include as much of the subsidiary facts as is necessary to disclose to the reviewing court the steps by which the trial court reached its ultimate conclusion of each factual issue."

Here, under the Treasury Regulations, §1.167(b)-(0)(a), no change could be made from the figure for

useful life used in computing the deduction for depreciation taken by petitioners on their returns unless there was a "clear and convincing basis for a change." The petitioners had used a 25-year life on their returns. The Commissioner determined a 50-year life. The Tax Court did not sustain the Commissioner but determined a 45-year life instead. Nowhere is there any showing of the basis for the change from the figure used by petitioners on their returns.

The only thing clear from the Tax Court's findings and opinion here is that it drew its ultimate finding of useful life from the original building, not the building as remodeled under the terms of the lease. It is impossible to know whether the whole of the original building was used, or the part of it remaining after the remodeling, or just how its useful life was determined.

The conclusion of the Court of Appeals is even more difficult to understand. As observed above, p. 8, the Court of Appeals concluded that the Tax Court's action "in determining lives and proportions by its own formula" was not clearly erroneous. It does not say, nor could it say, what that formula was, because no formula of any kind was spelled out by the Tax Court. Indeed, the Court of Appeals wholly misrepresents both the contentions of petitioners and the opinion of the Tax Court.

We submit for these reasons that there is a clear conflict with the decision of the Tenth Circuit in *James Petroleum Corp. v. Commissioner, supra.*

3. We suggest also that the decision below is in probable conflict with the decisions of this court cited

in 1 and 2 above, and for the reasons quoted above from the opinions of courts of appeals citing respectively the said decisions of this court.

4. The decision below, because of the failure of the Tax Court to make a finding as to the useful life of the building as remodeled, is in clear conflict with the decision of the same circuit in *Anaheim Union Water Company v. Commissioner,* 321 F. 2d 253, 260, the decision of the Fifth Circuit in *J. H. Robinson Truck Lines, Inc. v. Commissioner,* 183 F. 2d 739, 740, and the decision of the Sixth Circuit in *Loesch & Green Construction Company v. Commissioner,* 211 F. 2d 210, 212. Each of these cases holds that testimony which is unrebutted and unchallenged cannot be ignored.

Expert testimony here shows, as detailed above, page 7, (a) that the building as remodeled was a one-purpose building, (b) that the method of manufacture carried on in the building was a rapidly changing one, resulting in a continuing reconstruction program, and (c) that if the lessee removed its installations, which it could under its lease, the building would be an unusable building. This testimony was wholly unrebutted and unchallenged by respondent; and it has not been questioned by either court below.

Since the Tax Court failed to make a finding based on the above testimony, the decision of affirmance by the Court of Appeals is in conflict with the said decisions of the same, the Fifth and the Sixth circuits.

5. The decision below is also in conflict with *Spinks Realty Co. v. Commissioner,* App.D.C., 62 F. 2d 860.

The Tax Court here held that the "portion of the purchase price otherwise allocable to the demolished part [of the original building] must be treated as allocated

to the remaining property." [R. 36.] It referred in that connection to *Blumenfeld Enterprises,* 23 T.C. 665, 670, affirmed, 232 F. 2d 396 (C.A. 9). But it overlooked the fact of the lease; for in the *Blumenfeld* case itself the Tax Court, at page 671, relying *inter alia* on *Spinks Realty Co., supra,* stated that "the removal of a building in connection with obtaining a lease on the property is regarded as part of the cost of obtaining the lease."

This principle is, indeed, clearly shown in the *Spinks* case, pages 861-862, where, as here, property was demolished by a lessee pursuant to provision made in the lease. The property here being, as constructed by the lessee, a unique, one-purpose property, its life should therefore have been determined by the lease. Petitioners raised this issue in the Tax Court, but it was brushed aside by that court on the basis of the wholly unrelated character of the original building [R. 33]. Petitioners raised the same issue in the Court of Appeals [R. 48, 50-51, 53, 56, 58, 61], but there is nothing in that court's opinion to indicate that it gave it any consideration.

We submit, therefore, that the decision below is in conflict with the holding of the United States Court of Appeals for the District of Columbia Circuit in *Spinks Realty Co. v. Commissioner, supra.*

Wherefore, petitioners pray that this Court issue the writ of certiorari sought herein to the United States Court of Appeals for the Ninth Circuit.

Respectfully submitted,

GEORGE T. ALTMAN,
Attorney for Petitioners.

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APPENDIX.

Opinion of Court of Appeals on Issue of Depreciation.

United States Court of Appeals for the Ninth Circuit.

Louis Lesser and Jeanne Lesser, Petitioners, vs. Commissioner of Internal Revenue, Respondent. No. 19,814.

William Malat and Ethel Malet, Petitioners, vs. Commissioner of Internal Revenue, Respondent. No. 19,815.

Craig Adolphe Lesser Trust #2, et al., Petitioners, vs. Commissioner of Internal Revenue, Respondent. No. 19,816.

Cathy J. Lesser Trust #2, et al., Petitioners, vs. Commissioner of Internal Revenue, Respondent. No. 19,817.

Therese Ann Lesser Ford Trust #2, Petitioner, vs. Commissioner of Internal Revenue, Respondent, No. 19,818.

Francine S. Lesser Trust #2, et al., Petitioners, vs. Commissioner of Internal Revenue, Respondent. No. 19,819.

[November 9, 1965]

Petition to Review a Decision of the Tax Court of the United States.

Before: Barnes, Hamley and Jertberg, Circuit Judges

Barnes, Circuit Judge:

Petitioners appeal from a decision of the Tax Court, raising two issues: (1) the year of deductibility of a certain bad debt loss; and (2) the amount of a depreciation deduction allowable.

* * * * *

The Tax Court found a forty-five year depreciable life on the Helipot Building, and refused to accept as valid a composite rate for the life of the building based on the useful lives of its various components, as proposed by petitioners. The Tax Court found: "The matter . . . is not susceptible of any precise mathematial solution." We agree. The only way that the composite method urged by taxpayers could have benefited them would be if the Tax Court accepted not only taxpayers' theory, but their figures as to the expected lives of the various components *and* the fractions of the total value of the building attributable to each. We cannot agree the action of the Tax Court in determining lives and proportions by its own formula was clearly erroneous.

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